



Second Bi-monthly Monetary Policy 2019-20

Monetary and Liquidity Measures:

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting decided to:

- Reduce the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points to 5.75 per cent from 6.0 per cent with immediate effect.
- Consequently, the reverse repo rate under the LAF stands adjusted to 5.50 per cent, and the marginal standing facility (MSF) rate and the Bank Rate to 6.0 per cent.
- The MPC also decided to change the stance of monetary policy from neutral to accommodative.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

MPC's Outlook:

The RBI reduced the Repo rate by another 25 bps for the third time in a row, in line with market expectations, along with a change in stance to 'Accommodative' from 'Neutral'. More surprisingly, all the six MPC members voted unanimously to reduce the repo rate by 25 bps. The RBI also continued to revise its inflation forecasts while assuming a normal monsoon. The CPI inflation forecast was revised to 3.0-3.1% for H1FY20 and to 3.4-3.7% for H2FY20, with risks broadly balanced. In the April 2019 monetary policy the RBI had forecasted CPI inflation at 2.4% in Q4FY19, 2.9-3.0% in H1FY20 and 3.5-3.8% in H2FY20, with risks broadly balanced. The RBI stated that the revision in the inflation projections was considering factors like, sharper than expected pick-up in vegetable prices and recent broad based pick up in several food items imparting an upward bias to the near term trajectory of food inflation; a significant weakening of domestic and external demand conditions leading to a sharp broad-based decline of 60 bps in inflation excluding food and fuel in April, which has imparted a downward bias to the inflation trajectory for the rest of the year; volatile crude oil prices; and lastly moderation in inflation expectations of households. That said the RBI highlighted that there are uncertainties to its inflation projections in the form of uncertainties relating to the monsoon, unseasonal spikes in vegetable prices, international fuel prices and their pass-through to domestic prices, geo-political tensions, financial market volatility and the fiscal scenario.

The domestic GDP growth projections for 2019-20 were also revised downwards from 7.2% in the April 2019 policy to 7.0%, in the range of 6.4-6.7% for H1FY20 and 7.2-7.5% for H2FY20 with risks evenly balanced. The factors that the RBI attributed to the revision in the growth projections included, weakening of domestic investment activity and overall demand being weighed down partly by slowing exports; weak global demand due to escalation in trade wars may further impact India's exports and investment activity; lastly, while private consumption, especially in rural areas, has weakened in recent months; on the positive side, political stability, high capacity utilisation, the uptick in business expectations in Q2, buoyant stock market conditions and higher financial flows to the commercial sector augur well for investment activity.

Impact on the Bond Market and outlook:

Yield on the 10 year benchmark 7.26% 2029 G-sec closed at 6.93% compared to its previous close of 7.02%. The bond markets reacted positively, as the monetary policy outcome was dovish and also indicated that doors for further rate cuts may remain open going forward. This was because, not only did the RBI reduce the repo rate by 25 bps, but also changed the policy stance to 'Accommodative'; which was the cherry on the top, for the bond markers. More importantly, in the closing remarks of the policy statement the RBI highlighted that there is scope for the MPC to accommodate growth concerns by supporting efforts to boost aggregate demand, and in particular, reinvigorate private investment activity, while remaining consistent with its flexible inflation targeting

mandate. This has to be seen in light of the global growth trajectory which does not seem encouraging; and thus the change in monetary policy stance can be justified. Additionally the RBI's guidance on liquidity also seemed positive as the RBI has decided to constitute Internal Working Group to Review Liquidity Management Framework. The RBI did not seem very concerned on the fiscal deficit front and also applauded the government for its fiscal discipline. Overall given the RBI's focus on pushing economic growth, slowdown in global economic growth and the benign inflationary scenario, RBI may resort to further monetary easing going forward, if data points continue to remain supportive of lower interest rates. While the fixed income market is celebrating a dovish monetary policy, the focus will soon shift to the Union Budget, which the newly elected government will present soon. Also on the global front movement in international crude oil prices, further developments in trade tensions between the US and China and monetary policy actions of some of the developed nations are likely to give direction to bond yields. In the near term the bond yields may trade in a range with a declining bias.

Investments in Medium Duration Funds can be considered by moderate and aggressive investors with a horizon of 15 months and above. Investors, who are comfortable with intermittent volatility, can also look at strategies that focus at the longer end of the yield curve. i.e. Long duration funds, with a horizon of 24 months and above. Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above. Investors looking to invest with a horizon of up to 3 months can consider Liquid Funds, while Ultra Short Duration Funds and Arbitrage can be considered for a horizon of 3 months and above.

Equity Market outlook:

The RBI sounded cautious over the deceleration in global growth and its impact on Indian economy. Global financial markets have been volatile in the month of May 2019 mainly due to escalation of trade issues between US and China, and development of Brexit negotiations. This has triggered the risk-off sentiments amongst the investors and has led to demand for safe haven like debt securities and USD. This has also put downward pressure on inflation led by softening of commodity prices.

On the domestic side, the domestic macroeconomic data points have shown the signs of weakness in the economy with slower GDP growth in Q4FY19 and deceleration of core sector growth in April 2019. In the meanwhile, most of the high frequency data points also indicated muted growth in consumption demand. While, the credit flow from banks to Industry has risen, it has been muted for MSME sector.

On the other hand, capacity utilization has increased to 77% in Q4FY19 from 75.9% in Q3FY19. The manufacturing PMI also rose in May 2019 which is likely to have positive impact if it continues to strengthen further. The RBI suggested that the retail inflation has been in check as the rise in food and fuel prices is offset by lower core inflation. The RBI marginally increased its inflation outlook for H1FY20 from 2.9%-3.0% to 3.0%-3.1% while, reducing the inflation outlook to 3.4% to 3.7% in H2FY20 from 3.5% to 3.8%.

The RBI also lowered the GDP growth outlook for FY20 from 7.2% to 7.0% due to weak investment activities, exports and muted growth in private consumption demand. However, the RBI sounded positive on account of political stability, improving capacity utilization and increased credit flows. **Moreover, to push through growth impulses by reviving investment activities and private consumption demand, the RBI's MPC further cut the Repo rate by 25 bps and changed its policy stance from neutral to accommodative. This should auger well for market in the medium term and could be one of the reasons for revival in consumption and investment demand. From an Equity Mutual Fund perspective, investors should look at Large Cap and Multicap Funds for fresh investments and SIP into Midcap and Small caps funds can begin with a longer horizon. We have changed out investment strategy to 60% Lumpsum and rest 40% staggered over the next 3-4 months to buttress our positive stance on the equity markets.**

(Pls refer to the disclaimer in the next page)

Disclaimer: This document has been prepared on the basis of publicly available information, internally developed data and other sources believed to be reliable. HDFC Bank Limited ("HDFC Bank") does not warrant its completeness and accuracy. This information is not intended as an offer or solicitation for the purchase or sale of any financial instrument / units of Mutual Fund. Recipients of this information should rely on their own investigations and take their own professional advice. Neither HDFC Bank nor any of its employees shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this material. HDFC Bank and its affiliates, officers, directors, key managerial persons and employees, including persons involved in the preparation or issuance of this material may, from time to time, have investments / positions in Mutual Funds / schemes referred in the document. HDFC Bank may at any time solicit or provide commercial banking, credit or other services to the Mutual Funds / AMCs referred to herein.

Accordingly, information may be available to HDFC Bank, which is not reflected in this material, and HDFC Bank may have acted upon or used the information prior to, or immediately following its publication. HDFC Bank neither guarantees nor makes any representations or warranties, express or implied, with respect to the fairness, correctness, accuracy, adequacy, reasonableness, viability for any particular purpose or completeness of the information and views. Further, HDFC Bank disclaims all liability in relation to use of data or information used in this report which is sourced from third parties.

HDFC Bank House, 1 st Floor, C.S. No. 6 \ 242, Senapati Bapat Marg, Lower Parel, Mumbai 400 013. Phone: (91)-22-66521000, ext 1311, Fax: (91)-22-24900983 \ 24900858